In the Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-1444

MILLER BOX, INC., AND NORTHPORT BOX, INC., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

Petitioners seek review of the decision of the court of appeals that the evidence in this income tax refund suit was insufficient to support a jury verdict that salaries paid by petitioners to two of their employees were reasonable compensation under Section 162(a)(1) of the Internal Revenue Code of 1954.

1. Petitioners are corporations engaged in the manufacture and sale of wooden ammunition boxes. They were organized in the mid-1960's to handle the overflow of work on government contracts obtained by the Miller Box Company, a partnership which had been engaged in the same business for a number of years and had experienced an increased demand for its product (Pet. App. 20-22). Both petitioners were organized by James Hinton, whose family owned a 45-percent interest in the Miller Box partnership (Pet. App. 20). During the period in issue, Hinton owned 75 percent of the outstanding stock of Northport Box, Inc., and 75 percent of the outstanding stock of Miller Box, Inc. (Pet. App. 20; R. 39-40).

Pursuant to an agreement previously entered into between James Hinton and his brother, George Hinton, the latter was engaged to serve as general manager of the two corporations for a salary consisting of 20 percent of the before-tax profits of both corporations (Pet. App. 20-21, 22). George Hinton was a five-percent partner in the Miller Box Company, and a five-percent shareholder in both corporations (Pet. App. 20; R. 39-40). He had also been serving as plant manager for the partnership (a position he continued to hold concurrently with his new positions with the petitioners) at an annual salary of $7,600 (Pet. App. 20, 22). Gordon Miller, Jr., the son of Gordon Miller, Sr., a 50-percent partner in the partnership, was engaged to serve, first, as plant manager for Miller Box, Inc., and thereafter as plant manager for Northport Box, Inc., at a salary consisting of five percent of before-tax profits of both corporations (Pet. App. 20, 21, 22). Prior to that time, Gordon Miller, Jr., had been employed by the partnership at a salary of $200 per week (Pet. App. 35).

During the taxable periods in question[1], petitioners paid George Hinton and Gordon Miller, Jr., the following

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[1]The taxable years in question are as follows: Miller Box, Inc.—taxable years ended February 28, 1967 and February 29, 1968; Northport Box, Inc.—taxable year ended November 30, 1967.

amounts under these percentage-of-profit salary arrangements (Pet. App. 22):

	George Hinton	Gordon Miller, Jr.
Miller Box, Inc. taxable year ended Feb. 28, 1967	$197,372	$ 49,343
Northport Box, Inc. taxable year ended Nov. 30, 1967	$287,805	$ 71,951
Miller Box, Inc. taxable year ended Feb. 29, 1968	$657,845	$164,461

On audit, the Commissioner of Internal Revenue disallowed, in part, the deductions claimed by petitioners of the foregoing amounts. The disallowance was based on a determination that only $60,000 per year paid by Miller Box, Inc., and $30,000 per year paid by Northport Box, Inc., to George Hinton, and only $41,000 paid by Miller Box, Inc., and Northport Box, Inc., for their taxable years 1967 to Gordon Miller, Jr., constituted reasonable compensation for the services rendered by these individuals. No deduction was allowed Miller Box, Inc., for amounts paid to Gordon Miller, Jr. for its taxable year 1968 (Pet. App. 26).

The jury returned special verdicts in favor of both petitioners with respect to all amounts paid these individuals, and the district court denied the government's motion for judgment notwithstanding the verdict, except with respect to the amounts paid by Miller Box, Inc., to Gordon Miller, Jr.,for its fiscal year 1968, during which Miller was serving as plant manager for Northport Box only (Pet. App. 25-26, 30). The court of appeals reversed with respect to payments

made during petitioners' taxable years 1967.[2] It held that there was no probative evidence to support the jury verdicts that the amounts paid by petitioners to George Hinton and Gordon Miller, Jr. during those years were reasonable (Pet.App. 40).

2. Contrary to petitioners' contention (Pet. 10-13), the court of appeals did not deprive them of their right to trial by jury. While the question whether the amounts paid are fully deductible as "a reasonable allowance for salaries or other compensation for personal services actually rendered" under Section 162(a)(1) of the Internal Revenue Code of 1954 is a question of fact, petitioners had the burden of proving that amounts greater than those allowed by the Commissioner constituted reasonable compensation for the services rendered. *Botany Mills* v. *United States*, 278 U.S. 282. Hence, the jury verdict in their favor could not stand unless it was supported by sufficient evidence. *Boeing Co.* v. *Shipman*, 411 F. 2d 365, 374-375 (C.A. 5).

The court of appeals properly limited itself to the question whether there was sufficient evidence to support the jury verdict. While petitioners introduced evidence showing the nature and scope of the services performed by Hinton and Miller, the court of appeals concluded that there was no probative evidence which would establish the value of these services or that any amount greater than the salary deductions allowed by

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[2]The claim for refund of Miller Box, Inc. for its taxable year 1968 presented a separate accumulated earnings tax issue. This issue was not tried together with the reasonable compensation issue and has not yet been decided. As a result, final judgment has not yet been entered with respect to Miller Box, Inc.'s taxable year 1968 (Pet. App. 25-26).

the Commissioner would be reasonable compensation for their services. Moreover, the court observed that there was no evidence that the salaries to Hinton and Miller were paid under reasonable arm's-length contingent compensation contracts which fortuitously led to the payment of amounts greater than would ordinarily be considered reasonable (Pet. App. 37-40). Cf. Treasury Regulations on Income Tax (1954 Code), § 1.162-7. Indeed, as the court of appeals noted, James Hinton testified that he could have engaged an outsider to serve as plant manager of Northport Box for far less than even the $41,000 *allowed* as a deduction for salary paid to Gordon Miller, Jr. (Pet. App. 38-39).

Petitioners urge (Pet. 10) that the decision below conflicts with that of the Sixth Circuit in *Mayson Mfg. Co.* v. *Commissioner,* 178 F. 2d 115. There, the court held that corporate officers' salaries and bonuses based upon the profits of the business were not unreasonable where the officers were experienced and highly qualified, where all of the corporation's employees received substantial increases in compensation during the years at issue, and where the amounts were paid pursuant to a longstanding arrangement which resulted in increases and decreases over the year. In so holding, the Sixth Circuit stated that the taxpayer need not present proof as to compensation arrangements in comparable businesses[3].

This case, however, presents an entirely different situation. At the time of the commencement of the employment arrangements in question, Miller and Hinton were respectively earning $200 per week and $12,000 to

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[3]Here, the government introduced evidence of compensation in comparable business which demonstrated that the salaries in question were not reasonable (Pet. App. 38).

$15,000 per year for services on behalf of the Miller Box partnership (Pet. App. 35, 37). Shortly thereafter, the profit-sharing arrangement resulted in annual compensation in amounts ranging from $49,343 to $657,845 for the performance of the same functions.

Contrary to petitioners' suggestion, the decision below here does not hold that the reasonableness of the compensation may be established only by evidence from comparable businesses. All the court concluded was that some evidence demonstrating that the amounts paid were reasonable compensation is required to support the jury verdict. Here, the family relationship between the major owners of the businesses and the employees in question, the fact that Hinton and Miller were the only employees of petitioners paid on a profit-sharing basis, the relatively simple manufacturing process engaged in by petitioners, and the dramatic increase of the employees' compensation for the performance of the same undifferentiated functions performed for the Miller Box partnership, required the conclusion reached by the court of appeals that the verdict upholding the claimed salary deductions was unreasonable in the light of the evidence.

3. Finally, petitioners argue that the court of appeals could not enter judgment notwithstanding the verdict because the government failed to comply with Rule 50(b) of the Federal Rules of Civil Procedure. Rule 50(b) provides that a motion for judgment notwithstanding the verdict may be filed not later than 10 days after entry of judgment.

The special verdict returned by the jury on September 6, 1972, however, was not a judgment within the meaning of these Rules. Cf. *United States* v. *Indrelunas*, 411

U.S. 216; *State National Bank of El Paso* v. *United States*, 448 F. 2d 890 (C.A. 5). Contrary to petitioners' suggestion (Pet. 9), the filing of such a motion need not be deferred until after the entry of judgment. Under the Rule, a motion for judgment notwithstanding the verdict may be filed at any time after the verdict is returned until 10 days after the date the district court enters judgment in accordance with the jury verdict.[4] Here, by filing its motion for judgment notwithstanding the verdict on September 18, 1972, a long before the district court's formal entry of judgment on November 7, 1972, the government fully complied with the requirements of Rule 50(b).

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

JUNE 1974.

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[4]Prior to 1963, Rule 50(b) did, in fact, provide that the motion for judgment notwithstanding the verdict had to be filed within 10 days after the verdict. However, the Rule was then changed in order to bring the time requirements of Rule 50(b) into accord with those applicable to motions to amend the court's findings under Rule 52(b) and motions for new trials or to alter or amend judgment under Rule 59. See 9 Wright and Miller, *Federal Practice and Procedure*, §2537, p. 601, n. 44. The pre-1963 cases cited by petitioners (Pet. 9) are not germane. While *Neely* v. *Eby Construction Co., 386 U.S. 317, did involve the amended Rule, the timeliness of the motion was not in issue in that case.*